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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

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No. 64

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LIBSON SHOPS, INC., *Petitioner,*

v.

GUSTAVE F. KOEHLER, District Director of Internal Revenue, *Respondent.*

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**On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit**

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## MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

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---

## MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

---

Comes now Newmarket Manufacturing Company, by its counsel, and respectfully prays for leave to file a brief as *amicus curiae* in the above-entitled proceeding, and as grounds for this motion advises the Court of the following:

1. This proceeding involves an important question relating to the net operating loss deduction under sections 23(s) and 122 of the Internal Revenue Code of 1939. The question is whether the losses of a component corporation before a statutory merger may be carried over against profits of the resulting corporation after the merger.

2. Newmarket Manufacturing Company is a corporation chartered under the laws of Delaware. It is respondent in *United States* v. *Newmarket Manufacturing Company*, No. 216, October 1956 Term, which involves a question under the same sections. The question is whether losses sustained after a mere change in corporate domicile through a statutory merger may be carried back against profits earned before the change in domicile.

3. On June 28, 1956, the United States filed a Petition for a Writ of Certiorari in the *Newmarket* case. The Petition stated, as a basis for granting the Writ, that the question in the *Newmarket* case is similar to the question in this proceeding, and requested that its disposition be held in abeyance pending the Court's decision in this proceeding. On July 26, 1956, Newmarket Manufacturing Company filed a Brief in Opposition to the Petition.

4. The taxpayer in this proceeding filed its brief on the merits on September 27, 1956. Newmarket Manufacturing Company did not move before said date for leave to file a brief as *amicus curiae* in this proceeding because it could not then be determined whether the Company would have any interest providing a suitable ground for such a motion.

5. After the present term of Court began, counsel for Newmarket Manufacturing Company awaited the disposition of the Petition in the *Newmarket* case. The Court, however, has neither granted nor denied the Petition. Therefore, counsel for Newmarket Manufacturing Company is now under the impression that the Court will not dispose of the Petition until after its decision in this proceeding.

6. Counsel for Newmarket Manufacturing Company believes that the decision in this proceeding may substantially affect the disposition of the *Newmarket* case. In this connection, the Government is explicitly arguing in this proceeding that the Court of Appeals' decision in the *Newmarket* case is erroneous. (Resp. Br. 33.).

7. Counsel for Newmarket Manufacturing Company accordingly desires to submit to the Court significant legal matters which have not been explored by counsel for the taxpayer or counsel for the Government in this proceeding. These matters include tax statutes, legislative materials, administrative interpretations, and related considerations which warrant the thoughtful appraisal of the Court. Counsel for Newmarket Manufacturing Company believes that unless these matters are submitted for the Court's analysis, the issues before the Court will not be adequately presented and the Court will not be fully informed with respect to their appropriate resolution. He is particularly concerned in this respect because, in his view, there are serious errors and omissions in the brief submitted by the Government in this proceeding.

WHEREFORE, it is respectfully prayed that the Court grant this motion for leave to file a brief as *amicus curiae* in this proceeding.

Respectfully submitted,

LOUIS EISENSTEIN,
*Counsel for Amicus Curiae*

# BRIEF FOR NEWMARKET MANUFACTURING COMPANY AS AMICUS CURIAE

## STATEMENT

For the convenience of the Court we summarize anew the relevant facts in *United States* v. *Newmarket Manufacturing Company:*

On November 7, 1944, Newmarket Manufacturing Company was organized under the laws of Massachusetts. It engaged in the business of weaving synthetic fabrics. On September 26, 1951, a corporation bearing the same name was chartered under the laws of Delaware in order to remove the corporate domicile of the business to that state. The sole purpose of the change was to forestall the possible application of the Massachusetts Corporate Franchise Tax with respect to sales made in New York. Both courts below have agreed that this objective was a bona fide corporate purpose.[1] The authorized capital stock of the Delaware corporation consisted of 450,000 shares, with a par value of $2.50 per share. Of this total, 400 shares were temporarily issued to the Massachusetts corporation for $1,000 in cash. Between September 26, 1951, and November 30, 1951, the Delaware corporation did not carry on any business or incur any liabilities. Its sole asset was the $1,000. (R. 10-11, 49.)

At the close of business on November 30, 1951, the Massachusetts corporation was merged into the Delaware corporation. On the same day Articles of Consolidation were duly filed in Massachusetts and an Agreement of Merger in Delaware. No steps were taken to dissolve the Massachusetts corporation pursuant to any provisions of Massachusetts law. Under the Agreement of Merger the outstanding certificates in the Massachusetts corporation became certificates in the resulting corporation. The certificate for the 400 temporary shares was cancelled.

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[1] 233 F. 2d at 495.

After the merger the resulting corporation had the same business as the Massachusetts corporation, as well as the same officers and stockholders. Its operations continued in the same place and in the same manner. (R. 11-12, 19-49.)

Under the Agreement of Merger "the corporate identity, existence, purposes, powers, franchises, rights, and immunities" of the Massachusetts corporation were "merged into" and "fully vested" in the "Surviving Corporation."[2] The latter, "without other transfer," succeeded to "all the rights, privileges, powers, franchises and immunities" of "the Constituent Corporations," subject to "the restrictions, disabilities and duties of each of the Constituent Corporations." All their property was "thereafter as effectually the property of the Surviving Corporation" as of "the respective Constituent Corporations." All their liabilities attached to "the Surviving Corporation" and were enforceable against it "to the same extent as if" they "had been incurred or contracted by it." (R. 33, 42-43.)

Both the Massachusetts corporation and the resulting corporation reported their income on the basis of a fiscal year ending November 30th. The resulting corporation filed the return and paid the tax for the fiscal year ending November 30, 1951. It sustained a net operating loss of $660,370.97 for the fiscal year ending November 30, 1952. Later it filed a refund claim for the fiscal year 1951 on the ground that the loss was allowable as a net operating loss carry-back to that year. The claim was denied and this suit followed. The District Court rendered judgment in favor of the Government. The Court of Appeals reversed. (R. 5-8, 11-14, 49-55; Pet. 6-18.)

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[2] While this provision was subject to any exception "otherwise specifically set forth," no such exception was made.

## SUMMARY OF ARGUMENT

This case, like the *Newmarket* case, involves the appropriate application of section 122 of the Internal Revenue Code of 1939. Section 122 provides that if "the taxpayer" has a net operating loss, the loss is "a net operating loss carry-back" to a prior year or "a net operating loss carry-over" to a later year. Two conclusions derive from section 122. First, if a business has merely changed its corporate domicile through a statutory merger, losses sustained after the merger may be carried back against profits earned before the merger. Second, if corporations are combined through a statutory merger, losses of a component corporation before the merger may be carried over against profits of the resulting corporation after the merger.

I.

According to the Government, a loss sustained after a mere change in corporate domicile cannot be carried back on the ground that "the taxpayer" which earned the prior profit is not "the taxpayer" which sustained the later loss. But as the First Circuit has held, neither the letter nor the purpose of section 122 requires the result sought by the Government. If a business simply reincorporates via a statutory merger, the taxable entity remains the same because the attributes of corporate existence continue unimpaired. For purposes of the carry-back the change in corporate domicile is no different from a change in individual domicile. This conclusion is amply supported by the settled administrative practice of the Treasury. It is also confirmed by section 381 of the Internal Revenue Code of 1954, which builds on the premise that the carry-back is allowable under the Code of 1939.

In order to support its position the Government has invoked the aid of *New Colonial Co.* v. *Helvering*, 292 U.S. 435 (1934). However, that decision does not apply to a statutory merger—a succession by operation of law to the

attributes of corporate existence. In addition, the argument which the Government imputes to the *New Colonial* decision is directly opposed to this Court's decision in *Helvering* v. *Metropolitan Edison Co.*, 306 U.S. 522 (1939). While the Government has tried to distinguish the *Metropolitan Edison* decision, the alleged distinction is untenable. Our view of the *New Colonial* and *Metropolitan Edison* cases is the same as the administrative view of the Treasury which Congress has recognized and approved.

After a mere change in domicile the resulting corporation is liable for the tax of the "prior year" as "the taxpayer;" it pays the tax for that year as "the taxpayer;" and it sustains the loss for the later year as "the taxpayer." It does not suddenly cease to be "the taxpayer" when its loss as "the taxpayer" is applied to reduce its liability as "the taxpayer." In other contexts the Government will readily agree that a new domicile does not *ipso facto* create a new taxpayer. The Government cannot treat the same corporation as "the taxpayer" and not as "the taxpayer" in the light of whichever result happens to favor the Government.

## II.

The resulting corporation in a statutory merger is "the taxpayer" with respect to the prior taxable years of its component corporations. Hence it may carry over the losses previously sustained by a component corporation. In holding otherwise the decision of the Eighth Circuit departs from the relevant tax statutes, conflicts with a familiar pattern of adjudication, and ignores a persuasive administrative practice.

Section 122 must be read in conjunction with section 3797(a)(14) of the 1939 Code, which defines the term "taxpayer." The courts have repeatedly held, in accordance with the definition, that the resulting corporation is "the taxpayer" in regard to the previous opera-

tions of a component corporation. There is no reason to suspect or surmise that "taxpayer" has a peculiarly different connotation in section 122. Our view conforms to the "established policy" which the Treasury itself adopted and applied over an extended period. Until last year the Treasury regularly held that a resulting corporation could carry over prior losses of a component corporation. The Treasury's administrative practice is highly persuasive evidence of the meaning projected by section 122.

The Government asserts that if the carry-over is allowed, local law will improperly determine who is "the taxpayer." This argument misconceives the position which it criticizes. State law, of course, determines the rights and obligations which a resulting corporation acquires from a constituent corporation in a statutory merger. But federal law determines, in the light of its own uniform standard, whether the resulting corporation is "the taxpayer" with respect to the constituent corporation. Under that standard the resulting corporation is "the taxpayer" if it is endowed by operation of law with the rights and obligations of the constituent corporation. In final analysis, the essential difference between our view and the Government's view is that they focus on diverse aspects of local law. The Government contends that the controlling consideration is whether the resulting corporation and constituent corporation are initially chartered under the same certificate. We contend that the crux of the matter is whether the resulting corporation succeeds to the legal attributes of the constituent corporation.

The Government argues that the allowance of the carry-over will sanction tax avoidance because the losses of one corporation can then be offset against the profits of another. However, Congress has specifically indicated that there is no problem of avoidance here. Whenever Congress has been disturbed by avoidance through mer-

gers, it has expressly addressed itself to that problem. And Congress has continuously been undisturbed where, as in this case, a new group of stockholders has not acquired control or, indeed, any interest in the resulting corporation. In talking of tax avoidance the Government is improvising a tax policy of its own which Congress has consistently rejected. Moreover, even under the Government's view the profits of one corporation can be combined with the losses of another.

## ARGUMENT

The decision in this case, as in the *Newmarket* case, turns on the appropriate application of sections 23(s) and 122 of the Internal Revenue Code of 1939. Section 23(s) allows taxpayers a "net operating loss deduction computed under section 122." Section 122, in turn, is a formidable statute which prescribes various rules for the required calculation. It first defines a "net operating loss" as the excess of deductions over gross income. It then provides that if "the taxpayer" has a net operating loss, the loss is "a net operating loss carry-back" to a prior year or "a net operating loss carry-over" to a later year. The "amount of the net operating loss deduction" is "the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year," subject to various adjustments which are immaterial here.

"Tax statutes, no less than other statutes, derive vitality from the obvious purposes at which they are aimed." *Griffiths* v. *Commissioner*, 308 U.S. 355, 358 (1939). See also *Haggar Co.* v. *Helvering*, 308 U.S. 389, 394 (1940). Here the animating purpose is scarcely obscure. Loss carry-backs and loss carry-overs were designed to ameliorate the "unduly drastic consequences" of taxing income on an annual basis. *Lewyt Corp.* v. *Commissioner*, 349 U.S. 237, 244 (1955). Cf. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359 (1931). The losses of one year are applied against the profits of another, so

that the resulting tax reflects a more "realistic, balanced picture" of the enterprise. *Manning* v. *Seeley Tube & Box Co.*, 338 U.S. 561, 566. (1950). Or as the Second Circuit has stated in a comparable context, "it was considered equitable that lean years should be set off against lush ones" in order to "strike some sort of average." *Stanton Brewery* v. *Commissioner*, 176 F. 2d 573, 574 (2d Cir. 1949). See further Sen. Rep. No. 1631, 77th Cong., 2d Sess. 51 (1942); *United States* v. *Olympic Radio & Television*, 349 U.S. 232, 234 (1955).

The language and policy of section 122 readily yield two conclusions. First, if a business has merely changed its corporate domicile through a statutory merger, losses sustained after the merger may be carried back against profits earned before the merger. Second, if corporations are combined through a statutory merger, losses of a component corporation before the merger may be carried over against profits of the resulting corporation after the merger. Hence the decision of the First Circuit in the *Newmarket* case is correct and the decision of the Eighth Circuit in this case is erroneous. We shall now discuss both conclusions in the same order within the context of the two cases.

## I.

### IF A BUSINESS HAS MERELY CHANGED ITS CORPORATE DOMICILE THROUGH A STATUTORY MERGER, LOSSES SUSTAINED AFTER THE MERGER MAY BE CARRIED BACK AGAINST PROFITS EARNED BEFORE THE MERGER

In the *Newmarket* case the First Circuit dealt with a carry-back as authorized by section 122(b)(1)(B) of the 1939 Code. Section 122(b)(1)(B) states: "If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for the preceding taxable year." Clearly, the resulting corporation sustained "a net operating loss," and the "loss" occurred in a "taxable year beginning after December 31, 1949." Therefore,

the loss was treated as "a net operating loss carry-back for the preceding taxable year." The Government agrees that if the corporate domicile were still the same, the carry-back would be allowable. However, it insists that since the domicile was changed, the carry-back is gone. And so the legal issue is narrow and precise. Does the right to a carry-back strangely disappear if an enterprise moves its corporate domicile for a bona fide business purpose? The Court of Appeals easily resolved this question against the Government. It held that nothing in the statute required the bizarre result desired by the Government.

A. We turn to the Government's effort to justify its singular position. The Government contends that the deduction must be denied because the resulting corporation is not "the taxpayer" with respect to the year in which the carry-back would apply. The reasoning in behalf of this conclusion is essentially simple. Under section 122, the Government states, "the taxpayer" which earns the prior profit must also be "the taxpayer" which sustains the later loss. But, it continues, the Massachusetts corporation and the resulting corporation were different taxpayers; and they were different taxpayers because they were separate corporate entities.[3] In our view this reasoning is as dubious as it is simple. Indeed, we are rather puzzled by the Government's argument; on other occasions it has easily reasoned differently.[4]

The Government's abundant talk of "corporate entity" has little relevance in the present context. But it has the marked virtue of illustrating a cogent observation by Mr. Justice Cardozo. "Catch words and labels," he wrote, "are subject to the dangers that lurk in metaphors and symbols, and must be watched with circumspection lest they put us off our guard." *Henneford* v. *Silas Mason*

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[3] For the details of this reasoning, see Resp. Br. 8, 11, 19.

[4] See pp. 15-17, 25-26, *infra*.

*Co.*, 300 U.S. 577, 586 (1937).[5] Here the Government is methodically doing what Mr. Justice Cardozo wisely deplored. It has casually assumed that familiar phrases like "corporate entity" are appropriate substitutes for adequate analysis. We need hardly observe that legal tags "are not instruments of adjudication but statements of result." See *Wisconsin* v. *J. C. Penney Co.*, 311 U.S. 435, 444 (1940). And in tax law, too, labels and clichés may effectively beg the question to be answered. Perhaps even worse, they may almost obscure what is otherwise clear. Compare *Helvering* v. *Clifford*, 309 U.S. 331 (1940), in which this Court perceptively probed the concept of "ownership."

As Henderson long ago indicated, a corporation is an aggregate of legal attributes invested with a single name. See Henderson, *The Position of Foreign Corporations in American Constitutional Law* 165-168 (1918). Cf. Gray, *The Nature and Sources of the Law* 50-57 (2d ed. 1948); Dewey, *The Historic Background of Corporate Legal Personality*, 35 Yale L. J. 655 (1926). The phrase "corporate entity" is a convenient verbalism for summarizing what Chief Justice Marshall called the "qualities and capacities" conferred by law. Cf. *Dartmouth College* v. *Woodward*, 4 Wheat. 518, 636 (1935). At the very least, then, the "entity" continues as long as the attributes continue unimpaired. Of course, the legal essence of a statutory merger is that it maintains intact the attributes which constitute "the corporate *persona*" or "existing corporate life." *Guaranty Trust Co.* v. *N. Y. & Q. C. Ry. Co.*, 253 N.Y. 190, 200, 201, 170 N.E. 887, 890, 891 (1930).[6] This is precisely what happened when the corporate domicile was

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[5] Judge Learned Hand has gone further. He has diagnosed legal metaphors as "ordinarily a symptom of confused thinking." *Kingston Dry Dock Co.* v. *Lake Champlain Transp. Co.*, 31 F. 2d 265, 267 (2d Cir. 1929).

[6] See further pp. 20-23, 32-33, *infra*.

changed by a statutory merger under the laws of Massachusetts and Delaware. See Mass. Ann. Laws c. 156, § 46D (1948); Del. Rev. Code as amended c. 65, §§ 59-60 (1935). In the words of the Delaware statutes, after the merger "all the rights, privileges, powers and franchises" of each constituent corporation, as well as "all" its "property, real, personal and mixed," were "vested" in the resulting corporation; "and all property, rights, privileges, powers and franchises, and all and every other interest" were "thereafter as effectually the property of the resulting or surviving corporation as they were of the several and respective constituent corporations." Moreover, "all rights of creditors and all liens upon any property of any of said constituent corporations" were "preserved unimpaired," and "all debts, liabilities and duties of the respective constituent corporations" attached to the "resulting or surviving corporation," and were enforceable "against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it."[7]

In short, the attributes which are loosely described as "corporate entity" plainly survived the change in domicile. If they failed to survive, we are unable to understand the merger statutes under which the change occurred. In fact, as we shall shortly note, for other purposes the resulting corporation and the Massachusetts corporation are clearly

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[7] See also Mass. Ann. Laws c. 156, § 46D(b)(2); and p. 6, *supra*. The District Court excluded from the rights acquired by the resulting corporation "any right" which it "could not have exercised under the law under which it existed immediately prior to the merger." R. 49, *United States* v. *Newmarket Manufacturing Company*. We are a little puzzled by this exclusion, especially since the corporate purposes of the Masachusetts corporation were no broader than those of the resulting corporation. The latter was organized under the laws of Delaware, and so those laws determine the extent of its rights after the merger. See *Aspinook Corp.* v. *Commissioner of Corporations & Taxation*, 326 Mass. 327, 329, 94 N.E. 2d 366, 367 (1950). Under the Delaware statutes it acquired all the rights of the Massachusetts corporation.

the same taxable entity.[8] Admittedly, the migration from one state to another may entail the acceptance of new obligations and burdens. But the same is no less true if an individual moves from one state to another. Yet the Government would scarcely suggest that an individual entrepreneur cannot balance the losses suffered after his change of domicile against the profits realized before the change. By the same token, as Judge Magruder observed, "Income-tax-wise, there is no more reason why the Congress should choose to attach crucial significance to a mere change of corporate domicile than it would to a change of an individual taxpayer's domicile from Massachusetts to Delaware." In using the words "the taxpayer" Congress could not have required "the thin distinction between Newmarket Mfg. Co. before and after its incorporation in Delaware." 233 F. 2d at 497, 498.[9]

We are pretty much saying what the Treasury has said on other occasions. It is the settled view of the Treasury that where a business reincorporates, the taxable entity remains the same if the corporate rights and liabilities continue undisturbed. G.C.M. 24423, 1945 Cum. Bull. 145; Rev. Rul. 54-269, 1954-2 Cum. Bull. 114. Both of these rulings construed section 52 of the 1939 Code, which provides that "Every corporation" subject to the income tax "shall make a return." In G.C.M. 24423 the Treasury considered whether a new taxable entity was created on the conversion of a state bank into a national bank. If

[8] See pp. 25-26, 33-37, *infra*.

[9] During the two months before the statutory merger the Delaware corporation did not qualify as a full-fledged taxable entity because it was still quiescent. It had not earned any income, transacted any business, or perfected its organization by issuing stock to its contemplated stockholders. See Regulations 111, § 29.52-1; Rev. Rul. 55-503, 1955-2 Cum. Bull. 577. Cf. I.T. 3871, 1947-2 Cum. Bull. 62; Rev. Rul. 55-94, 1955-1 Cum. Bull. 419. When a corporate domicile is moved, there is usually a short interval between the acquisition of the new charter and the consummation of the change.

so, then the old entity and the new entity had to file separate returns for the year in which the conversion occurred. The "fundamental question," the Treasury said, "is whether, in fact, a new legal entity is created upon conversion." The correct answer, it then added, depends on "an interpretation of the section of law pursuant to which the conversion is accomplished." After appraising the relevant section the Treasury held that a new taxable entity was not created and hence only one return was "required for the entire taxable year." 1945 Cum. Bull. at 146-147. The Treasury particularly relied on this Court's decision in *Metropolitan Bank* v. *Claggett*, 141 U.S. 520 (1891), which held that the entity is "one and the same" before and after the change. The "same body" continues "with the same officers and stockholders," as well as "the same property, assets," and "business." *Id.* at 527.

The Treasury reasoned similarly in Rev. Rul. 54-269. There a corporation had been organized under special acts of Connecticut. State law authorized it to surrender its special charter for a new charter under the general corporation statutes. If it elected to do so, "its corporate existence" was deemed to "continue," but without "either the privileges or obligations" of the special acts "under which it was originally incorporated." The corporation turned in its special charter and filed a new certificate under the general statutes. Again the question was whether for federal tax purposes the resulting corporation was "a continuation of the same corporation" or "a new separate taxable entity." And again the answer turned on the continuation of the corporate attributes under the governing local law. While the corporation now functioned under a new certificate, it was still the same "taxable entity." The loss of "privileges" bestowed by the special acts was dismissed as immaterial. At the same time the Treasury carefully distinguished the case where the attributes of corporate life come to an end and the

property is sold to another corporation. *Id.* at 115. In that situation, the Treasury held, the vendee corporation is a "distinct" entity.[10] For further rulings to the same effect, see I.T. 2005, III-1 Cum. Bull. 299 (1924); C.S.T. 13, 1945 Cum. Bull. 430; and cf. G.C.M. 11387, XII-1 Cum. Bull. 427 (1933). But cf. S.M. 3451, IV-2 Cum. Bull. 83 (1925), involving a purchase of corporate assets.

These rulings seem to leave little more to be said, except as the Government has proceeded to ignore them.[11] Here, as there, the corporation merely reincorporated in response to its business needs. And under the explicit terms of the reincorporation the existing corporate "rights, privileges, powers and franchises" remained intact. Therefore, as the First Circuit concluded, its decision approved a principle which had already "proved acceptable to the Commissioner." 233 F. 2d at 499. If a corporation constitutes the same taxpayer for the purpose of filing a single tax return, it certainly constitutes the same taxpayer for the purpose of applying a loss carry-back.[12]

B. The First Circuit's conclusion is further confirmed by section 381 of the Internal Revenue Code of 1954. Section 381 provides for the transfer of various tax "items" from one corporation to another. It con-

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[10] The Treasury also held that if the corporate attributes terminate rather than continue, the situation falls within the principle of *New Colonial Co.* v. *Helvering*, 292 U.S. 435 (1934), discussed at pp. 20-29, *infra*.

[11] In its brief (Resp. Br. 19) the Government refers to section 52, but refrains from mentioning these rulings. And despite these rulings it boldly and erroneously declares (at p. 20) that section 52 has "always been recognized as demanding separate returns by a predecessor and successor corporation . . . of their respective incomes for the periods covering their respective lives."

[12] In view of the Treasury's rulings the First Circuit's conclusion seems *a fortiori* correct. The present question is whether the resulting corporation is the same "taxpayer" rather than the same "corporation." See pp. 43-45, *infra*.

sists of three subsections. Subsection (a) states the so-called "general rule" for the section. The transfer of items is allowed where all or substantially all the property of a corporation is acquired by another corporation in one of four types of tax-free reorganization. Among them is the reorganization described in section 368(a)(1)(F) of the 1954 Code, which was formerly section 112(g)(1)(F) of the 1939 Code. This reorganization is "a mere change in identity, form, or place of organization, however effected." The simple change of domicile in the *Newmarket* case was a "mere change" of this kind. 233 F. 2d at 497.[13] Subsection (b) of section 381 sets forth "operating rules" or "conditions and limitations" which apply to the transfer of items otherwise allowed. It declares that except "in the case of an acquisition in connection with a reorganization described in" section 368(a)(1)(F), the transferee corporation "shall not be entitled to carry back a net operating loss for a taxable year ending after" the transfer "to a taxable year" of the transferor corporation.[14] Subsection (c) of section 381 enumerates a number of items which are transferred from one corporation to another. These items include loss carry-overs, but they do not include loss carry-backs.

Section 381 is particularly revealing here. Neither subsection (a) nor subsection (c) grants a loss carry-back to a successor corporation. Yet subsection (b) provides

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[13] The Government has not disputed that the merger was "a mere change" in "place of organization" within the meaning of section 112(g)(1)(F) of the 1939 Code. Cf. *George Whittell & Co.*, 34 B.T.A. 1070 (1936); Rev. Rul. 54-193, 1954-1 Cum. Bull. 106.

[14] Subsection (b) also provides that a mere change in corporate domicile does not affect the taxable year of the enterprise. The change neither closes the taxable year nor starts a new one. The same taxable entity is deemed to continue, as the Treasury has held under the 1939 Code. See pp. 15-17, *supra*.

"operating rules" which obviously assume that the carry-back is allowable where the business has merely changed its corporate domicile. In these circumstances only one inference seems reasonable. Section 381 plainly presupposes that under prior law a loss carry-back is already available if there is but "a mere change" in the "place of organization." Unless the section is viewed in this light, there is no deduction to which the "operating rules" can apply in such cases. Nor is there any doubt that section 381 contemplates a loss carry-back in favor of the resulting corporation if a business is merely reincorporated elsewhere. To quote the report of the Senate Finance Committee, "assume corporation X merges into corporation Y on December 31, 1954, in a statutory merger with Y's charter continuing after the merger. If Y has a net operating loss in 1955, such loss cannot be carried back to a taxable year of X but shall be a carry-back to a taxable year of Y. If, however, corporation X, in a reorganization described in subparagraph (F) of section 368(a)(1), merely changes its identity, form, or place of organization, the resulting corporation is entitled to carry back its net operating loss to a taxable year of X prior to the reorganization." Sen. Rep. No. 1622, 83d Cong., 2d Sess. 276 (1954). Cf. H. R. Rep. No. 1337, 83d Cong., 2d Sess. A135 (1954). See further Mertens, Law of Federal Income Taxation, Code Commentary § 381(b):2 (1955).

This quotation necessarily summarizes the law of loss carry-backs in the 1939 Code, as well as in the 1954 Code, where there is a mere change of corporate domicile. For as we have just indicated, the 1954 Code does not contain any new provision which grants the carry-back in this situation. It simply picks up where the 1939 Code left off. It builds on the premise that the carry-back is already allowed and continues to allow it. In short, the

carry-back allowed under the 1954 Code is equally allowed under the 1939 Code.[15]

C. In order to justify its conclusion the Government has invoked the aid of *New Colonial Co.* v. *Helvering*, *supra*.[16] The First Circuit correctly held that the *New Colonial* decision is out of place here. 233 F. 2d at 498.

In the *New Colonial* case a corporation was engaged in the business of producing and selling ice. It became financially embarrassed, and a new corporation was organized to take over the enterprise. The stockholders exchanged their shares in the old corporation for shares in the new corporation, which then acquired the assets of the business. Later the new corporation carried forward the operating losses of the old corporation. This Court held that the losses were not available because the new corporation was not the same taxpayer as the old corporation.

We fail to see how the Government derives much comfort from the *New Colonial* decision. There, as the Court expressly noted, the "corporate existence of the old corporation continued" for almost two years, though "it transacted no business and had no assets or income." 292 U. S. at 438. The entity which sustained the loss still remained separate and apart from the entity which claimed the loss. For that matter, the old entity was still free to embark on a new business and to apply the loss carry-over against any income earned in that business. If the tax-

[15] We are not unaware of the general statement in the committee reports that "No inference is to be drawn from the enactment" of section 381 "whether any item or tax attribute may be utilized by a successor or a predecessor corporation under existing law." H. R. Rep. No. 1337, 83d Cong., 2d Sess. A135 (1954); Sen. Rep. No. 1622, 83d Cong., 2d Sess. 277 (1954). In the case of carry-backs, however, section 381(b) is meaningful only as it incorporates "existing law."

[16] See Resp. Br. 11-16, 21-23.

payer's position was correct, there were in effect two taxpayers entitled to the same carry-over. And so, as Judge Magruder aptly declared, "What is conclusive, we think, is that the *New Colonial* case did not involve a statutory merger"—a succession by operation of law to the attributes of corporate existence. 233 F. 2d at 498. Indeed, in the *New Colonial* case this Court pointedly stated that the "transaction was voluntary and contractual, not by operation of law." 292 U.S. at 441.[17]

Moreover, the argument which the Government imputes to the *New Colonial* decision is directly opposed to this Court's opinion in *Helvering* v. *Metropolitan Edison Co.*,

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[17] The Government, by way of footnote (Resp. Br. 23, n. 7), has tried to dismiss this significant statement. It argues that a merger is just as "voluntary and contractual" as other kinds of inter-corporate transfers. If the argument is correct, we must infer that this Court painstakingly made a meaningless statement. However, there is no reason to indulge in this dim view of what the Court carefully said. In distinguishing a transaction "by operation of law," the Court used a familiar legal expression as lawyers ordinarily understand it. And the expression, as usually understood, refers to statutory mergers of corporate attributes in gross. In *United States* v. *Seattle Bank*, 321 U.S. 583 (1944), which involved the tax consequences of a statutory merger, the Government made a similar argument that failed to persuade. The Court's observations there equally apply here. As the Court stated, "in a broad sense, few if any transfers ever take place 'wholly by operation of law' for every transfer must necessarily be a part of a chain of human events, rarely if ever other than voluntary in character." The phrase "operation of law" focuses upon "the immediate mechanism by which the transfer is made effective. If that mechanism is entirely statutory, effecting an automatic transfer without any voluntary action by the parties, then the transfer may truly be said to be 'wholly by operation of law.'" *Id.* at 587-588. Cf. *Oswego Falls Corp.*, 26 B.T.A. 60, 75-76 (1932), *aff'd*, 71 F. 2d 673 (2d Cir. 1934). Even the Government is not convinced by its essay in semantics. Elsewhere in its brief it correctly assumes that the phrase "operation of law" refers to statutory mergers in the customary legal sense. Resp. Br. 35-38.

306 U.S. 522 (1939). In that case a subsidiary corporation issued bonds at a discount. Later it was absorbed by its parent corporation, which then retired the bonds. The issue before the Court was whether the resulting entity could deduct the unamortized discount and related expenses attributable to the bonds. In resolving this question the Court meticulously contrasted "a true merger or consolidation" and a sale of assets. A deduction is allowable, the Court held, "if there has been a true merger or consolidation whereby the identity of the corporation issuing the bonds continues in the successor and the latter becomes liable for the debts of the former by operation of law." On the other hand, a deduction is no longer available after "a mere sale by one corporation of all its assets to another which assumes the liabilities of the former." 306 U.S. at 526. The Court then sustained the disputed deduction because the fusion of the two corporations had "all the elements of a merger" and came "within the principle that the corporate personality of the transferor is drowned in that of the transferee." *Id.* at 529.

Judge Magruder has nicely distilled the essence of the *Metropolitan Edison* decision. "What the Court was saying, of course, was that the transferee in a statutory merger should be deemed to be continuing in itself the corporate life of the now-defunct component, and that it followed from this conceptual identity that the two corporate entities were to be treated for a substantive purpose in the income tax as the same taxpayer." 233 F. 2d at 499. The Government's present understanding of the *New Colonial* opinion runs headlong into this basic principle of the *Metropolitan Edison* opinion. True, the Government has made a heroic attempt to distinguish between the two cases. But the result scarcely justifies the effort.

The Government admits that under the *Metropolitan Edison* decision statutory mergers are significantly different from non-merger transactions. However, it contends

that the decision is "far removed" from the present dispute over net operating losses.[18] While the argument is not entirely clear to us, we shall try to summarize it. If a bond indebtedness is assumed in a merger, the Government says, the resulting corporation "*itself* sustains the unamortized bond discount loss *after* the reorganization, and hence can deduct the loss *as its own.*" But in non-merger transactions, whether they are taxable or tax-free, the consideration is adjusted "to reflect prospective losses and expenses attributable to the bonds," and therefore the successor corporation does not sustain a loss when payment is later made.[19] This argument completely misses the point of the *Metropolitan Edison* decision. As the Second Circuit has expressed the controlling principle, the deduction for amortization carries over because in a merger "the transferee corporation succeeds by operation of law to all the rights and liabilities of the former company and carries forward its identity." *American Gas & Elec. Co.* v. *Commissioner*, 85 F. 2d 527, 530 (2d Cir. 1936). See *Stanton Brewery* v. *Commissioner*, *supra*, at 57; *Koppers Company* v. *United States*, 134 F. Supp. 290, 296 (Ct. Cls. 1955); *E. & J. Gallo Winery* v. *Commissioner*, 227 F. 2d 699, 703 (9th Cir. 1955).[20]

The Government has managed to forget what it previously said in the *Metropolitan Edison* case itself. After thoughtfully analyzing the decisions the Government declared with assurance that the "only sound" basis for the amortization deduction is that "the identity of the

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[18] Resp. Br. 35-39.

[19] *Id.* at 37-38. (Italics in original.)

[20] For additional statements of the principle, see *Turner-Farber-Love Co.* v. *Helvering*, 68 F. 2d 416, 417 (D.C. Cir. 1933); *American Gas & Electric Co.* v. *United States*, 17 F. Supp. 151, 157 (Ct. Cls. 1936); *Illinois Power & Light Corp.*, 33 B.T.A. 1189, 1196 (1936); *Connecticut Electric Service Co.*, 35 B.T.A. 444, 449 (1937).

issuing corporation was preserved," and not that "the survivor considered as a separate corporation sustained a loss of its own." Brief for the Petitioner, pp. 46-47, *Helvering* v. *Metropolitan Edison Co., supra.* The wisdom of the Government's earlier view is easily sustained by an example. *A* and *B* are two corporations; *A* has issued bonds at a discount; and the assets of *A* are to be acquired by *B*. If *B* acquires the assets in a tax-free reorganization by issuing its stock to the shareholders of *A* in exchange for the stock of *A*, then *B* is not entitled to any deduction for amortization with respect to the bonds. But if *A* merges into *B* and the stockholders of *A* acquire a similar portion of *B*'s stock, then *B* is entitled to the deduction. See *American Gas & Electric Co.* v. *United States, supra,* at 157.[21] Yet in both cases the bond obligation is similarly assumed, and in both cases the amount of stock issued by *B* to the shareholders of *A* is adjusted "to reflect prospective losses and expenses attributable to the bonds."

In the *New Colonial* case this Court left little doubt that the net operating loss deduction and the bond amortization deduction turn on the same basic principle. For at the close of its opinion the Court referred approvingly to *Turner-Farber-Love Co.* v. *Helvering, supra,* which dealt with amortization of discount, and, like the *Metropolitan Edison* case, dwelt on the difference between a merger and other transfers of corporate assets. 292 U.S. at 441.[22] Here, as elsewhere, we are again merely saying what the Government has already said. In the *Metropolitan Edison* case the Government considerably emphasized

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[21] See further other cases cited in note 20, *supra.*

[22] The Court coupled the *Turner-Farber-Love* decision with *Athol Mfg. Co.* v. *Commissioner,* 54 F. 2d 230 (1st Cir. 1931), involving a loss carry-over. See further *American Gas & Elec. Co.* v. *Commissioner, supra,* at 530, where these two decisions are similarly cited as illustrations of the same principle.

that the rule of the *New Colonial* case extends to deductions for amortization as well as deductions for losses.[23] It particularly indicated that, in so far as mergers are concerned, no distinction should be drawn between the deduction of losses and the deduction of amortization. "Upon the general reasoning" in the *New Colonial* opinion, the Government observed, "*it is possible to argue* that even in the case of a true merger or consolidation" the resulting corporation "is nevertheless to be regarded as a separate taxable entity and is not entitled to deductions for losses or for amortization of bond discount or expense which would have been allowable to its predecessor if it had continued in business, although the Court did point out that there the transaction was voluntary and contractual and not by operation of law."[24] Apparently, as of early 1939, when the *Metropolitan Edison* case was argued and decided, the Treasury was by no means firmly persuaded that the *New Colonial* decision extends to loss deductions by corporations resulting from a statutory merger.

More recently the Treasury has ruled, as we are now saying, that the *Metropolitan Edison* case and the *New Colonial* case are to be read *in pari materia*. If the corporate succession is by operation of law, the former applies. If it is not by operation of law, the latter applies. P.S. No. 62, 5 C.C.H. Fed. Tax Rep. ¶6118 (1950).[25] On this occasion the Treasury dealt with the carry-forward of

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[23] See Brief for the Petitioner, pp. 19, 38 *et seq.*, *Helvering* v. *Metropolitan Edison Co.*, *supra*. The Government noted that the *New Colonial* opinion cited the *Turner-Farber-Love* case "with approval." *Id.* at 19.

[24] *Id.* at 42. (Italics supplied.) The remainder of the Government's argument sought to establish that the corporate transactions in the *Metropolitan Edison* case did not constitute a "true" merger.

[25] For the convenience of the Court we are including the whole of P.S. No. 62 in the Appendix.

contributions made to an exempt employees' pension trust. Section 23(p)(1)(A) of the 1939 Code provides that "an employer" may deduct "an amount not in excess of 10 per centum" of the cost of funding past service credits. A contribution beyond this limitation is "deductible in the succeeding taxable years." The corporate employer in this case had funded the past service credits; had deducted 10 percent of the cost in each of three years; and had then merged into another company. The question was whether the resulting corporation could deduct the balance of the contribution in later years. This problem, the Treasury declared, "is one to be resolved in accordance with the line of distinction to be drawn between" the *New Colonial* decision and the *Metropolitan Edison* decision. Since the corporate assets had been acquired "pursuant to a statutory merger which by operation of law effected a fusion of the assets and liabilities of the respective companies," the resulting corporation could deduct the balance "to the same extent as" the component corporation "would have been entitled had it continued in business."[26]

Congress has expressly confirmed the views of the Treasury as carefully articulated in P.S. No. 62.[27] In January of this year Congress enacted an amendment relating to the carry-over of excess contributions to an

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[26] Section 381(c)(11) of the 1954 Code now specifically covers the carry-over of pension contributions made by a predecessor corporation.

[27] The Government has evidently struggled a good deal with the obvious purport of P. S. No. 62. It tries to escape embarrassment by noting that there the taxpayer "assumed the obligations under the pension plan." Resp. Br. 40. We doubt whether this observation helps matters too much. In transfers other than mergers the same obligation is equally assumed; yet under P. S. No. 62 the carry-over is nevertheless denied. The only basis for the diverse results is the principle which that ruling enunciates. Moreover, P. S. No. 62 deals with the carry-over of a pre-merger outlay, as in the case of losses—not "post-merger expense," as the Government for some reason thinks. Resp. Br. 39.

employees' trust. Pub. L. No. 396, 70 Stat. 7, 84th Cong., 2d Sess. The statute extends the benefit of such carry-overs to certain situations where a subsidiary corporation has liquidated its assets into its parent corporation under section 112(b)(6) of the 1939 Code. These are cases in which the applicable local law prevented a statutory merger because the two corporations were organized in different states. In these restricted circumstances the amendment treats the liquidation as if it were a merge and hence the parent corporation is allowed to deduct the excess contributions made by the subsidiary corporation. For present purposes the accompanying committee reports are very informative. See H.R. Rep. No. 1594, 84th Cong., 1st Sess. 2 (1955); Sen. Rep. No. 1375, 84th Cong., 2d Sess. 1 (1956). "Under the 1939 Code," they state, "whether tax benefits and elective rights were available to a successor corporation when the assets of two or more predecessor corporations were combined in a tax-free reorganization or liquidation depended upon the legal form in which the combination was effectuated." The reports then indicate that the amendment is designed to grant a carry-over which is otherwise already allowed where the subsidiary corporation is merged into the parent corporation. In other words, within its narrow compass the statute equalizes tax-free liquidations with tax-free mergers. Of course, the amendment is intelligent tax legislation only as it correctly presupposes an existing tax distinction between mergers and other intercorporate transfers.[28] We may no less confidently state that the statute is a plain-spoken legislative approval of administrative practice—actual rather than presumed.[29]

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[28] For a similar distinction by the Treasury, see further Rev. Rul. 54-269, *supra*, at 115, which is discussed at pp. 16-17, *supra*.

[29] Cf. *Helvering* v. *Winmill*, 305 U.S. 79 (1938); *Helvering* v. *Reynolds Co.*, 306 U.S. 110 (1939); *Helvering* v. *Oregon Insurance Co.*, 311 U.S. 267 (1940); *Commissioner* v. *Wheeler*, 324 U.S. 542 (1945); *Bochm* v. *Commissioner*, 326 U.S. 287 (1945).

Finally, we should add that in this Court the Government has already successfully made the same distinction with respect to loss carry-backs.[30] In *Standard Paving Co.* v. *Commissioner*, 190 F. 2d 330 (10th Cir. 1951), a parent corporation dissolved a subsidiary corporation. Later the parent corporation sought to carry back its losses against income of the subsidiary corporation. The Tenth Circuit disallowed the carry-back on the basis of the *New Colonial* case.[31] The parent corporation then applied for certiorari on the ground that the Tenth Circuit's decision was in conflict with the Second Circuit's decision in *Stanton Brewery* v. *Commissioner, supra.*[32] The Government, however, opposed the petition because the alleged conflict was non-existent. It made the very argument which we are making now. "The assertion of conflict," said the Government, "is not well founded." The *Stanton Brewery* decision "was based squarely on the premise that the resulting corporation in a merger is the same taxpayer as the component corporation. Here there was no merger. . . ." Brief for the Respondent in Opposition, p. 15, *Standard Paving Co.* v. *Commissioner*, 342 U.S. 860 (1951). In response to the Government's argument this Court denied certiorari.[33] If the *Stanton Brewery* decision is not at odds with the *Standard Paving* decision, it is equally at ease with the *New Colonial* decision.[34] Conflicts

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[30] For the Treasury's administrative practice to the same effect, see also pp. 38-39, *infra*.

[31] See also *Eleanor H. Vendig*, 22 T.C. 1127 (1954). Cf. *Follansbee Steel Corp.* v. *United States*, 109 F. Supp. 635 (W.D. Pa. 1953); *Donohue* v. *United States*, 112 F. Supp. 660 (E.D. Mo. 1953).

[32] See pp. 39-45, *infra*.

[33] Compare *Gramm Trailer Corp.*, 26 T.C. No. 84 (1956), where the Tax Court similarly distinguished between a merger, which continues the "powers, privileges and immunities" of a corporation, and a liquidation, which brings them to an end.

[34] The Government did not request certiorari in the *Stanton Brewery* case, though it now insists that there is a sharp conflict with the *New Colonial* decision.

do not appear and disappear to suit the periodic preferences of the Government in a particular case.

Perhaps Judge Learned Hand has provided the best commentary on the present significance of the *New Colonial* decision. While he dissented at length in the *Stanton Brewery* case, he did not consider the *New Colonial* decision relevant enough to mention. See 176 F. 2d at 578.[35]

D. The crux of the matter seems fairly obvious. If the corporate domicile had remained the same, the carry-back would have been allowable. We fail to understand why a mere change in corporate domicile produces a significant change in tax consequences. Congress devised loss carry-backs and carry-overs in order to aid business and stimulate enterprise. See H.R. Rep. No. 855, 76th Cong., 1st Sess. 9-10 (1939). They are important instruments of fiscal policy which are designed to foster economic growth and stability. We are unaware of any reason for supposing that Congress sought to distinguish between a business which moves its domicile and a business which retains its domicile. And the Government has not pointed to any statute which compels such a whimsical conclusion. We may put the same conclusion a little differently. The resulting corporation was liable for the tax of the prior year as "the taxpayer;"[36] it paid the tax for that year as "the taxpayer;" and it sustained the loss for the later year as "the taxpayer." It did not suddenly cease to be "the taxpayer" when its loss as "the taxpayer" was applied to reduce its liability as "the taxpayer." This conclusion makes good sense as well as good law.

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[35] We are not implying that the Government is always anxious to apply the *New Colonial* decision even where it evidently applies. The Government's views tend to remain flexible. It may overlook the decision if it can collect more tax by doing so. See, *e.g.*, *Mary Miller*, 22 T.C. 293 (1954).

[36] See pp. 33-36, *infra*.

Undoubtedly, in other circumstances the Government would gladly agree with us that a new domicile does not *ipso facto* make a new taxpayer. We shall cite two random illustrations. Under section 41 of the 1939 Code "the taxpayer" cannot change his method of computing income unless he secures the consent of the Commissioner. See Regulations 118, § 39.41-2(c).[37] Similarly, under section 46 of the 1939 Code "a taxpayer" cannot change "his accounting period" unless he obtains "the approval of the Commissioner." See Regulations 118, § 39.46-1.[38] If the Government's present view is correct, a corporate taxpayer can freely change its accounting method or its accounting period without pausing to consult the Commissioner. It need only change its domicile through a statutory merger. For according to the Government, the resulting corporation is then a new taxpayer which starts off afresh. Yet we are sure that if a corporate taxpayer made any such argument, the Commissioner would be quite unimpressed. And so here we may appropriately invoke a venerable principle which is as relevant in tax law as elsewhere. What is good for the goose is also good for the gander. Or to alter the metaphor, principles of tax law do not mysteriously change because the shoe is on one foot rather than the other. See Magruder, J., in *Portland Oil Co.* v. *Commissioner*, 109 F.2d 479, 487-488 (1st Cir. 1940), *cert. denied*, 310 U.S. 650 (1940). Cf. *Pearce* v. *Commissioner*, 315 U.S. 543, 547 (1942). The Government cannot treat the same corporation as "the taxpayer" and not as "the taxpayer," in the light of "whichever favors the Government." Cf. *Rosenman* v. *United States*, 323 U.S. 658, 663 (1945).

In sum, the deduction which the First Circuit sustained falls well within the language and policy of section 122.

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[37] Section 41 of the 1939 Code has been succeeded by sections 441 and 446 of the 1954 Code.

[38] Section 46 of the 1939 Code has been succeeded by section 442 of the 1954 Code.

In the words of the Second Circuit, our view is "the one which will carry out the evident statutory purpose," since it assures carry-backs and carry-overs to "what is essentially a continuing enterprise, entitled to all their benefits in ameliorating otherwise harsh tax consequences of fluctuating profits or expanding business." *Stanton Brewery v. Commissioner, supra,* at 577.

## II.

## IF CORPORATIONS ARE COMBINED THROUGH A STATUTORY MERGER, LOSSES OF A COMPONENT CORPORATION BEFORE THE MERGER MAY BE CARRIED OVER AGAINST PROFITS OF THE RESULTING CORPORATION AFTER THE MERGER

We have argued that a mere change in corporate domicile through a statutory merger does not entail a forfeiture of the net operating loss deduction. And so we further submit, as the First Circuit held, that our position is correct regardless of what the answer may be in this case, where a number of corporations were merged into one. See 233 F. 2d at 497, 499.[39] In any event, however, the decision of the Eighth Circuit should be reversed for the reasons we shall now explore.

A. In the present case sixteen corporations were engaged in the business of selling women's wear. Another corporation provided management services for them. They were all controlled by the same persons in the same relative proportions. The sales corporations merged into the management corporation. Under the applicable local statutes the resulting corporation succeeded by operation of law to all the rights and obligations of the component corporations. In computing its income for the first taxable year after the merger, the resulting corporation deducted net operating loss carry-overs deriving from the prior operations of three component corporations. The Commissioner disapproved the deduction and the Court of

[39] Cf. Resp. Br. 34-35.

Appeals for the Eighth Circuit sustained his determination. 229 F. 2d 220 (8th Cir. 1956). It disallowed the carry-overs on the ground that the resulting corporation and the component corporations were not the same "taxpayer" under section 122. In our view this decision departs from the relevant tax statutes; it conflicts with a familiar pattern of adjudication; and it ignores a persuasive administrative practice.

Section 122, like other provisions in the 1939 Code, must be read in conjunction with a second statute which the Government has ignored throughout its analysis. We are referring to section 3797, in which Congress has defined various basic terms that appear in the Code.[40] Among these terms is the word "taxpayer"—the very word in dispute here. Subsection (a)(14) of section 3797 defines "taxpayer," as used in the Internal Revenue Title, as "any person subject to a tax imposed by this title"—unless "otherwise distinctly expressed or manifestly incompatible with the intent thereof."[41] The courts have repeatedly held that the resulting corporation in a statutory merger or consolidation is "the taxpayer" with respect to the prior taxable years of a component corporation. It is "the taxpayer" because it is the person "subject to" the taxes for those years; and it is the person "subject to" the taxes for those years because it succeeds by operation of law to the attributes of the component corporation. See *Stanton Brewery* v. *Commissioner, supra,* at 575-576. Hence it "is obligated and birthmarked by statute" with "all" the "primary liability" which adheres to those attributes. *Bowman Hotel Corp.*, 24 B.T.A. 1193, 1203 (1931). The Court of

[40] To illustrate, while the Government has criticized the Second Circuit's decision in *Stanton Brewery* v. *Commissioner, supra,* it does not in the least mention section 3797, which the Second Circuit considered very pertinent. See Resp. Br. 28-32.

[41] Section 3797(a)(1) defines "person" as including a "corporation."

Claims has aptly summarized the matter. "The surviving corporation in a statutory merger represents the combination of a business that was operated before in the form of its constituents. For practical, business, and many tax purposes, it is treated the same as many of its components which formed it. It accedes to the rights and privileges as well as the obligations of its components by operation of law. It becomes primarily liable for the tax obligations of its components as the taxpayer and not secondarily liable as a transferee." *Koppers Company* v. *United States, supra,* at 295.

For example, section 272(a)(1) of the 1939 Code provides, "in the case of any taxpayer," that if the Commissioner asserts a deficiency against "the taxpayer" in a stated manner, "the taxpayer" may file a petition with the Tax Court for a redetermination. The resulting corporation is "the taxpayer" which is entitled to file the petition in response to an alleged deficiency of a component corporation. *Bowman Hotel Corp., supra; Trahern Pump Co.,* 27 B.T.A. 363 (1932); *Skaneateles Paper Co.,* 29 B.T.A. 150 (1933), *aff'd on another issue,* 71 F. 2d 584 (7th Cir. 1934); *Alaska Salmon Co.,* 39 B.T.A. 455 (1939); *Falstaff Brewing Corp.,* P.-H. B.T.A. Memo. Dec. ¶ 39,371 (1939); *Northern Ohio Railway Co.,* 6 T.C.M. 1230 (1947). Cf. *Bond Crown & Cork Co.,* 19 T.C. 73 (1952); *International Mining Corp.,* P.-H. B.T.A. Memo. Dec. ¶ 41,146 (1941). Again, section 276(b) authorizes the Commissioner and "the taxpayer" to extend the time for assessing a deficiency. The resulting corporation is "the taxpayer" which may prolong the period for assessing taxes attributable to a component corporation. *Phillips* v. *Lyman H. Howe Films Co.,* 33 F. 2d 891 (3d Cir. 1929); *Commissioner* v. *Oswego Falls Corp.,* 71 F. 2d 673 (2d Cir. 1934); *Skaneateles Paper Co., supra;* G.C.M. 7310, IX-1 Cum. Bull. 237 (1930). Cf. *United States* v. *Oswego Falls Corp.,* 113 F. 2d 322 (2d Cir. 1940).

The Government pretty much concedes that the cases just cited have been correctly summarized. It seeks to avoid them by suggesting that they recognize a successor corporation as "the same taxable entity" as a predecessor corporation "solely for the purpose of enforcement or redetermination of the surviving tax liabilities."[42] But these accepted holdings cannot be so easily disparaged as involving procedural issues. Procedure is a means to an end. To say that a resulting corporation is "the taxpayer" for procedural purposes is only to say in another way that it is "the taxpayer" for substantive purposes. It is "the taxpayer" which may dispute an alleged deficiency because it is "the taxpayer" which is liable for the deficiency if sustained. Otherwise there is little point to the holdings which we have cited. They are rooted in the premise that the resulting corporation is, by operation of law, "liable as principal for the obligations" of the component corporation. *United States* v. *Oswego Falls Corp., supra,* at 325. As the Tax Court has concisely stated, the statutes which fix this liability "are more than rules of procedure—they are rules of property." *Bowman Hotel Corp., supra,* at 1206. See also *Commissioner* v. *Oswego Falls Corp., supra,* at 676; *Stanton Brewery* v. *Commissioner, supra,* at 575-576; *Skaneateles Paper Co., supra,* at 157; *Alaska Salmon Co., supra,* at 456; G.C.M. 7310, *supra,* at 239. Cf. *Bailey* v. *Railroad Company,* 22 Wall. 604, 629-630, 640 (1874).

If any doubts remain, they are fully resolved by other decisions to which we now turn. For these decisions emphasize that the component corporation and resulting corporation are the same "taxpayer" for substantive purposes, too. The net effect of the former's operations before the merger enters into the latter's calculation of gain or loss after the merger.

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[42] Resp. Br. 26-27.

Section 505(a)(1) of the 1939 Code grants a deduction for federal income taxes paid or accrued in the taxable year.[43] It is well settled, of course, that taxes are deductible only by the person on whom they are imposed. The deduction is not available to someone else though he has assumed the burden of paying them.[44] In *Adrian & James, Inc.*, 4 T.C. 708 (1945), a resulting corporation paid and deducted the income tax computed on the prior earnings of a component corporation.[45] The Commissioner disapproved the deduction. He declared that the deduction was confined to payments "by a taxpayer in discharge of a liability for its own income taxes," as distinguished from payments "in discharge of a liability for such taxes of another corporation." Then he inferred that the deduction was not allowable on the ground that the resulting corporation had paid the tax "as an assumed debt and not as an income 'tax liability' of its own." *Id.* at 717-718. The Tax Court was only partially persuaded. It concurred in the Commissioner's statement of principle, but not in his attempted application. It concluded that "under a statutory merger the payment by the surviving corporation of Federal income taxes due from a merged corporation" is "payment of a tax liability of the surviving corporation and consequently deductible by it." *Id.* at 718.

The Tax Court returned to the same theme in *Koppers Coal Co.*, 6 T.C. 1209 (1946). A resulting corporation had paid interest on tax deficiencies attributable to several component corporations, and then deducted the payment

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[43] The deduction is allowed in computing the personal holding company tax.

[44] *Magruder* v. *Supplee*, 316 U.S. 394 (1942). Two years ago Congress made a narrow exception for local taxes on real estate which are apportioned between seller and buyer. Int. Rev. Code of 1954, § 164.

[45] This decision construed section 406(a)(1) of the 1938 Act, 52 Stat. 561, which became section 505(a)(1) of the 1939 Code.

as "interest" on "indebtedness." See Int. Rev. Code of 1939, § 23(b). The Commissioner again denied the deduction on the theory that the liabilities were not the indebtedness of the resulting corporation. The Tax Court was still unconvinced. It emphasized anew that a resulting corporation is "not a transferee" but "in fact the predecessor corporations;" that "the income tax liabilities of such corporations" are "consequently the indebtedness of the new corporation;" and that "in paying such indebtedness" the resulting corporation is "not satisfying the indebtedness of another." The interest which it pays is interest on its own indebtedness. 6 T.C. at 1223. See further *A. D. Saenger*, 38 B.T.A. 1295 (1938). But cf. *Rodney, Inc.* v. *Commissioner*, 145 F. 2d 692 (2d Cir. 1944), where the corporation was dissolved rather than merged.

The cases which we have cited are well fortified by this Court's decision in *Helvering* v. *Metropolitan Edison Co., supra.*[46] See also, to the same effect, *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. 2d 695 (4th Cir. 1929); *New York Central R. Co.* v. *Commissioner*, 79 F. 2d 247 (2d Cir. 1935), *cert. denied*, 296 U.S. 653 (1935); *American Gas & Elec. Co.* v. *Commissioner, supra; American Gas & Electric Co.* v. *United States, supra; Illinois Power & Light Corp.*, 33 B.T.A. 1189 (1936); *Connecticut Electric Service Co.*, 35 B.T.A. 444 (1937).[47] The *Metropolitan Edison* decision and all the other cases rest on a familiar hornbook principle. A resulting corporation "takes on the obligations" of a component corporation "directly by operation of law." *Stanton Brewery* v. *Commissioner, supra,* at 575. Or to return to Judge Magruder's way of putting

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[46] See pp. 21-26, *supra.*

[47] Compare further, in regard to the capital stock tax, *Early* v. *Southgate Corp.*, 136 F. 2d 217 (4th Cir. 1943); *United States* v. *Northwestern Nat. Bank & T. Co. of Minneapolis*, 137 F. 2d 761 (8th Cir. 1943).

it, the two corporations are "treated for a substantive purpose in the income tax as the same taxpayer."

In the light of our analysis the appropriate conclusion seems clear. The resulting corporation in a statutory merger is "the taxpayer" with respect to the prior taxable years of its component corporations. Hence when carry-overs attributable to a component corporation are involved, the same "taxpayer" is offsetting earlier losses against later gains. In denying the carry-overs in the present case, the Eighth Circuit has simply held that the words "the taxpayer" mean something different from what they usually mean in the 1939 Code. However, there is no reason to suspect or surmise that these words have a peculiar connotation in section 122. In section 3797 Congress has supplied its own dictionary of meaning for the term "taxpayer," and that meaning has been repeatedly applied. True, section 3797 indicates that its definitions may not apply in a particular context if a different meaning is "distinctly expressed" or the usual meaning is "manifestly incompatible" in the specific setting. See p. 32, *supra*. But nothing within or without section 122 in the least suggests that the usual meaning must be replaced here. While the connotation of a word may vary, it does not follow that diverse meanings should be gratuitously discovered—especially where Congress has emphasized that any departure from its definition must be "distinctly" stated or "manifestly" required. And so "the changeable meaning" which the Government prefers for present purposes cannot be justified. Cf. *United States* v. *Olympic Radio & Television, supra,* at 235; *Commissioner* v. *Estate of Bedford*, 325 U.S. 283, 292 (1945); *Crane* v. *Commissioner,* 331 U.S. 1, 8, 12 (1947). As the Court of Claims has stated, "if the surviving corporation is treated for tax purposes as the same 'taxpayer' as its components or predecessors, the carry-backs and carry-overs are covered by the code." *Koppers Company* v. *United States, supra,* at 294.

The view which we are taking only echoes the view which the Government itself "adopted and followed" over "many years." *Koppers Company* v. *United States, supra,* at 296. To quote its own candid admission, the Government had "an established policy" that "following a statutory merger or consolidation the resultant corporation should be granted the privilege of carrying over or carrying back net operating losses across the line of fusion, provided no violation of Section 129 or other applicable provision of the Code or Regulation was involved."[48] This policy was expressed in "unpublished rulings" which reflected the Treasury's "administrative position" in its "handling of cases." The rulings held that "except in instances where the merger or consolidation is brought about for the purpose of tax avoidance, the corporation surviving a statutory merger or consolidation" would "be permitted to carry over a net operating loss of a component in that merger to the extent that the absorbed corporation would have been able to carry over that loss had it continued its separate existence; also that a resultant corporation would be permitted to carry back across the line of merger a net operating loss limited to the portion of such loss that is allocable to assets received by the resultant corporation from a merged component whose premerger income is sought to be offset." Brief for the United States, pp. 20-21, *Koppers Company* v. *United States, supra.*[49] Only in March of last year did the Government forsake its "established policy." *Id.* at 3.[50]

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[48] The significance of section 129 is considered at pp. 45-50, *infra.*

[49] This "established policy" on loss carry-backs and carry-overs "had evolved from a continuing study of the entire subject, it having previously been the position of the Chief Counsel that although a resultant corporation should be granted the tax privileges which its component corporations would have enjoyed had they continued their separate existence, an exception should be made in the case of net operating losses." *Id.* at 3.

[50] For further evidence of the Treasury's prior "established policy," see *Morrisdale Coal Mining Co.*, 19 T.C. 208, 210 (1952), where the Commissioner conceded that a resulting corporation was entitled to carry over a loss sustained by a component corporation.

We believe that the Government was right before and is wrong now. Its understanding of section 122 has not improved with additional meditation.[51] In any event, the administrative practice of the Treasury is highly persuasive evidence of the meaning projected by the statute. And that practice should not be rejected in the absence of very cogent considerations which make disapproval inevitable. See *Logan* v. *Davis*, 233 U.S. 613, 627 (1914); *Great Northern Ry. Co.* v. *United States*, 315 U.S. 262, 275 (1942). Nor is it particularly important that the Treasury has recently tried to reverse itself. The Treasury's change of mind does not express any peculiar specialized knowledge or experience. It merely mirrors an erroneous view of this Court's decision in the *New Colonial* case. Therefore, it is not entitled to any particular deference as an administrative construction. Cf. *Helvering* v. *Hallock*, 309 U.S. 106, 121 (1940); *White* v. *Winchester Club*, 315 U.S. 32, 39 (1942); *Great Northern Ry. Co.* v. *United States*, *supra*, at 275.

B. Our conclusion is amply buttressed by the Second Circuit's decision in *Stanton Brewery* v. *Commissioner*, *supra*, and the Court of Claims' decision in *Koppers Company* v. *United States*, *supra*. While these cases involved the unused excess profits credit carry-over and carry-back,[52] their essential reasoning applies no less to the net operating loss carry-over and carry-back.[53]

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[51] The Government says, "In cases involving the question whether net operating losses may cross the line of a statutory merger, the Government has consistently urged that they may not and that *New Colonial* controls." Resp. Br. 40-41. In view of the Government's administrative practice, this statement is no less remarkable than wrong. For our discussion of the *New Colonial* decision, see pp. 20-29, *supra*.

[52] Int. Rev. Code of 1939, § 710(c).

[53] As the Government recently declared, "No significant difference between carry-backs and carry-overs of unused excess profits credits and net operating loss carry-backs and carry-overs is apparent." Brief for the United States, p. 10, *Koppers Company* v. *United States*, *supra*.

In the *Stanton Brewery* case an operating company merged into its parent company, which continued to carry on the same business. For its first taxable year after the merger the resulting corporation deducted the component corporation's unused excess profits credits of the two previous years. The carry-overs were more than enough to remove all current excess profits tax liability. The Second Circuit sustained the carry-overs in an opinion by Judge Clark. His analysis is admirably cogent and thorough.[54] The deduction is approved because the resulting corporation is "an all-embracing whole which absorbs the rights and privileges, as well as the obligations, of its constituents." 176 F. 2d at 575. Since it is "subject to" the tax obligations of the component corporation, it is also "the taxpayer." In the *Koppers* case a parent and three subsidiaries merged into a newly formed corporation.[55] The latter then sought to apply an unused excess profits credit carry-back against the income reported by the component corporations on a consolidated excess profits tax return. Once more the Commissioner disallowed the deduction, and once more he was reversed. The reasoning of the Court of Claims was closely akin to the reasoning of the Second Circuit. See also *E. & J. Gallo Winery* v. *Commissioner, supra.*[56]

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[54] Judge Learned Hand dissented. 176 F. 2d at 578. But his disagreement rested largely on a special group of excess profits tax statutes providing an alternative base period credit for a so-called "acquiring corporation." See Int. Rev. Code of 1939, §§ 740, 742. Compare, however, the Court of Claims' contrary reasoning from the same statutes in *Koppers Company* v. *United States, supra,* at 293-294.

[55] The parent and one of the subsidiaries were Massachusetts trusts. The other two subsidiaries and the resulting corporation were chartered by Delaware.

[56] See also *Moldit; Inc.* v. *Jarecki,* 53-2 U.S.T.C. ¶ 9551 (N.D. Ill. 1953), *appeal dismissed pursuant to stipulation,* 7th Cir., July 26, 1954 (net operating loss carry-back). But cf. *Commonwealth Title Co.* v. *Rothensies,* 124 F. Supp. 274 (E.D. Pa. 1954) (net op-

The Government is not kindly disposed toward the *Stanton Brewery* decision. It particularly criticizes the decision for allegedly holding that "local law is to govern who is 'the taxpayer' entitled to carry over a federal tax credit or loss from one year to another." On the basis of this criticism, the Government also accuses the decision of ignoring "the settled principle" that federal tax statutes are to be construed in a uniform manner in accordance with their own criteria.[57] These observations display a failure in analysis which is somewhat surprising. The *Stanton Brewery* opinion does not say what the Government criticizes it for saying. And the Government relies no less on local law than the decision which it disapproves.

We cheerfully concede that the question whether a corporation is "the taxpayer" is "a federal question." This issue "is not resolved by local characterization" that reflects matters of local concern. The fact that a resulting corporation is deemed "the taxpayer" under state law does not determine that it is "the taxpayer" under federal law. Cf. *Lyeth* v. *Hoey*, 305 U.S. 188, 193 (1938); *United States* v. *Pelzer*, 312 U.S. 399, 402 (1941); *Estate of Rogers* v. *Commissioner*, 320 U.S. 410, 413 (1943). But this truism does not mean that state law can be scrupulously disregarded as the Government seems to believe. With few exceptions corporations are creatures of state law, and state law determines their rights and obligations. *Hopkins Savings Assn.* v. *Cleary*, 296 U.S. 315 (1935). Indeed, as we previously observed, a corporation is but

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erating loss carry-over and unused excess profits credit carry-over). The Tax Court has refused to abide by the *Stanton Brewery* decision. See *California Casket Co.*, 19 T.C. 32, 39 (1952) (unused excess profits credit carry-over); *E. & J. Gallo Winery*, 12 T.C.M. 414, 415 (1953), *rev'd*, 227 F. 2d 699 (9th Cir. 1955) (unused excess profits credit carry-over). Its reluctance to do so derives essentially and erroneously from *New Colonial Co.* v. *Helvering*, *supra*. Compare, however, *Gramm Trailer Corp.*, *supra*; and see further discussion at pp. 20-29, *supra*.

[57] Resp. Br. 30-31. See also *id.* at 25-26.

an aggregate of rights and obligations which the law treats as a person. See pp. 13-14, *supra*. The content of those rights and obligations must be consulted if federal law is not to operate in a vacuum. See, *e.g.*, *Helvering* v. *Metropolitan Edison Co.*, *supra*, at 526 *et seq.* Hence "an inquiry into state law seems inescapable." *Helvering* v. *Fuller*, 310 U.S. 69, 74 (1940). See also *Hulburd* v. *Commissioner*, 296 U.S. 300, 315 (1935); *Magruder* v. *Supplee*, *supra*, at 396. Cf. *United States* v. *Loan & Bldg. Co.*, 278 U.S. 55, 59 (1928).

What this Court said in *Morgan* v. *Commissioner*, 309 U.S. 78 (1940), is especially illuminating here. "State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed. Our duty is to ascertain the meaning of the words used to specify the thing taxed. If it is found in a given case that an interest or right created by local law was the object intended to be taxed, the federal law must prevail no matter what name is given to the interest or right by state law." *Id.* at 80-81. See also *Helvering* v. *Stuart*, 317 U.S. 154, 162 (1942). If we may slightly revise the language of the *Morgan* opinion, state law determines the rights and obligations which a resulting corporation acquires from a component corporation via a statutory merger. Federal law determines, in the light of its own uniform standard, whether the resulting corporation is "the taxpayer" with respect to the component corporation. And, as we have already indicated, that standard is now well fixed. The resulting corporation is "the taxpayer" if it is endowed by operation of law with the rights and obligations of the component corporation. See p. 36, *supra*. It is entirely immaterial whether state law continues to call the two corporations "distinct" rather than "identical." Cf. *Burk-Waggoner Assn.* v. *Hopkins*, 269 U.S. 110, 114 (1925). But the federal standard must inevitably apply to the substance of what local law has created, for otherwise there is nothing to which the standard can apply.

Actually the Government is no more oblivious of local law than we are. The essential difference between its view and our view is that they focus on diverse aspects of local law. We contend, as the cases have held, that the resulting corporation is "the taxpayer" in relation to a constituent corporation if the former succeeds to the latter's rights and obligations. The Government contends that the resulting corporation is "the taxpayer" in regard to a constituent corporation only if both are initially chartered under the same certificate.[58] The Government's argument stands or falls on no more than this simple proposition. It is all a matter of one or two pieces of paper. We doubt whether even the Government truly approves this approach to the solution. For as we have seen, the Treasury has ruled that a predecessor corporation and a successor corporation are the same taxable entity if the corporate attributes continue essentially undisturbed. See 15-17, *supra*. And the same rulings unmistakably indicate that this conclusion ultimately rests on the content of applicable local law.

Nor is the Government on stronger ground when it strenuously insists that in any event the resulting corporation and its component corporations are not the "same" or "identical." In the present case, for example, the Government urges that the relevant state statutes "do not purport to erase, or to deny recognition to, the separate existences of the transferor and transferee corporations, and that they do not purport to authorize a deduction by one of the corporations of net operating losses sustained by the other for purposes of computing their respective federal income tax liabilities." Then the Government adds what we do not dispute—that the merger laws of a state can confer "only what it is within the power of the state to give; that is, rights, privileges and obliga-

[58] All the corporations involved in a statutory merger are "constituents," no matter which becomes the "resulting corporation."

tions created by the laws of that particular state.'" They cannot be read as creating credits or deductions under federal revenue laws, passing with corporate assets, like good will or trademarks."[59]

We need not probe this reasoning to determine whether it is beyond criticism. Even if it is wholly impeccable, it is beside the point. "In law also the right answer usually depends on putting the right question." *Estate of Rogers* v. *Commissioner, supra,* at 413. The question here is not whether the resulting corporation after a merger may be properly considered the same "corporation" as a component corporation for purposes of local law. The question rather is whether the resulting corporation is "the taxpayer" with respect to the component corporation for purposes of federal tax law. As the Second Circuit has explained in *Stanton Brewery* v. *Commissioner, supra,* the carry-over or carry-back adheres to "the taxpayer," not to "the corporation." And so, under the controlling standard of federal law,[60] the allowance turns on "the simple determination of the laws of corporate rights and liabilities," without any need to unravel "difficult and complex questions of corporate entity." It is enough that the resulting corporation, as "taxpayer," is "liable for the taxes" of the component corporation,

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[59] Resp. Br. 25, n. 9. See also *id.* at 31.

[60] See p. 42, *supra.* This conclusion does not mean, as the Government seeks to argue, that the availability of the carry-over hinges on "whether the local law purports to treat tax deduction privileges created by Congress as assignable from one corporate taxpayer to another." Resp. Br. 31, n. 14. We are not even slightly suggesting that the right to the carry-over derives from a grant by local law. The content of local law is relevant only for the purpose of ascertaining whether the resulting corporation qualifies as "the taxpayer" in accordance with the federal standard.

"whatever may be the merits of the academic controversy over their fate." 176 F. 2d at 576.[61]

The Government has one other quarrel with the *Stanton Brewery* decision which merits but a few words. It contends, in oblique fashion, that the resulting corporation is liable as transferee, and not as "taxpayer," with respect to the prior operations of a component corporation.[62] This argument is no more than an elementary error, and the Government should surely know better. The resulting corporation is not secondarily liable as transferee. It is "primarily liable" as "the taxpayer." See, *e.g.*, the distinction drawn in *Koppers Coal Co., supra,* at 1223, between the liability of a taxpayer and the liability of a transferee. See further *Oswego Falls Corp., supra,* at 68-76, *aff'd*, 71 F.2d at 676; *A. D. Saenger, supra,* at 1302; and discussion at pp. 32-37, *supra.*

C. In order to persuade this Court to affirm the decision below the Government raises the specter of tax avoidance. Unless the carry-over is denied, says the Government, a taxpayer may "reduce its own average business income" with "losses sustained by other taxpayers in other businesses." The taxpayer's interpretation "would extend the benefits of section 122 "to a corporation which absorbs another corporation with a history of operating losses, with a view to deducting the losses from its own future income. In effect, it would lend judicial approval to the exploitation, for bargaining purposes, of the tax benefits afforded by the net operating loss carry-over provisions."[63] This kind of eloquent argument is often the last refuge when all other arguments fail. As Judge

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[61] Cf. *Aspinook Corp.* v. *Commissioner of Corporations & Taxation,* 326 Mass. at 331, 94 N.E. (2d) at 368: "Under the Delaware statute it is only 'the *separate* existence of all the constituent corporations' which 'shall cease.' From the moment of consolidation the 'existence' of each of these corporations is to be a combined existence manifested solely through and operating in the name of the consolidated corporation." (Italics in original.)

[62] Resp. Br, 31, n. 15.

[63] *Id.* at 44, 45.

Magruder has recently observed, while a desire to save taxes is not "rightly" significant, "it sometimes is permitted to give a spurious flavor" to an argument. *Channing* v. *Hassett*, 200 F. 2d 514, 516 (1st Cir. 1952). See also *Commissioner* v. *Korell*, 339 U.S. 619, 625-626 (1950). Fortunately, we need not spend much time on the fears which the Government would like to create. Here Congress has specifically spoken on the subject of tax avoidance and left little more for the Government to say. We are referring to section 129 of the 1939 Code, which Congress enacted in 1943. Revenue Act of 1943, § 128, c. 63, 58 Stat. 21.

Section 129 is directed against acquisitions made to avoid income or excess profits taxes. Specifically, it deals with two kinds of acquisitions: (1) a person or persons acquire "control of a corporation;" and (2) a corporation acquires, in a tax-free transaction, "property of another corporation, not controlled, directly or indirectly, immediately prior to such acquisition, by such acquiring corporation or its stockholders."[64] If any such acquisition is made and "the principal purpose" of the acquisition is "evasion or avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such person would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed." Under section 129, then, a deduction is not disallowed merely because new stockholders have acquired corporate control. The deduction is frustrated only if they have obtained control for the proscribed purpose of avoidance.

In enacting section 129 Congress was largely disturbed by the developing practice of acquiring corporations "with current, past, or prospective losses" in order to reduce

[64] Section 129(a) defines "control" as "the ownership of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or at least 50 per centum of the total value of shares of all classes of stock of the corporation."

taxes. See H. R. Rep. No. 871, 78th Cong., 1st Sess. 24, 49 (1943); Sen. Rep. No. 627, 78th Cong., 1st Sess. 26, 58 (1943). And Congress was especially attentive to the acquisition of loss corporations through statutory mergers. In the explicit words of the Ways and Means Committee, "This section is designed to put an end promptly to any market for, or dealings in, interests in corporations or property which have as their objective the reduction through artifice of the income or excess profits tax liability." Among "the tax benefits sought" are "carry-overs and carry-backs of losses," and one of "the devices" used is "an acquisition which follows by operation of law in the case of a corporation resulting from a statutory merger or consolidation." H. R. Rep. No. 871, *supra*, at 49.

In view of the text and context of section 129 several conclusions easily emerge. First, Congress recognized that after a merger is completed, prior losses of a component corporation may be deducted from later profits of the resulting corporation.[65] Second, while Congress was sensitively aware of tax avoidance through mergers of loss corporations, it carefully allowed the carry-over even if a new group of stockholders gained "control" of the fused enterprise—unless "the principal purpose" of the merger was tax avoidance. Third, where Congress has so deliberately defined the area of avoidance to be policed, it is not for the Government to speak fearfully of cases which failed to worry Congress. Here, clearly, the mergers were well beyond the line drawn by Congress, for precisely the same individuals were in control before and after the merger. "When such clear choice of ideas has been made in the drafting of a specific provision of the law, its language

[65] The regulations proceed from the same premise. They expressly embrace cases where a profitable corporation is combined with a loss corporation "by such transfer or other action as is necessary to bring" the losses "into conjunction with the income." Regulations 111, § 29.129-3(1); Regulations 118, § 39.129-3(b)(1).

must be taken at its face value." *Helvering* v. *Wood*, 309 U.S. 344, 348 (1940).[66]

The matter does not end there. In 1954, after a decade of administrative experience, Congress re-examined the problem of avoidance, and once more it was unimpressed by the fears which allegedly trouble the Government. Indeed, Congress appreciably broadened the allowance of loss carry-overs to successor corporations, so that tax consequences would "depend less upon the form of the transaction than upon the economic integration of two or more businesses into a unified business enterprise." See Int. Rev. Code of 1954, § 381(a)(b)(c)(1); H. R. Rep. No. 1337, 83d Cong., 2d Sess. 41 (1954); Sen. Rep. No. 1622, 83d Cong., 2d Sess. 52 (1954).[67] In other words, Congress again deemed it wise to permit the losses of one business to be offset against the profits of another business in a

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[66] The Government has argued that under section 122 the profits and offsetting losses must derive from the same business. Resp. Br. 5, 7, 9, 41 et seq. "The provisions of the statute," the Government says, "their legislative history, and the relevant decisions make it clear that the carry-over privilege is not available" unless there is "a continuity of business enterprise, *i.e.*, the current year's income against which the taxpayer seeks to offset the prior year's loss must be derived from substantially the same business as that which produced the loss." *Id.* at 5. We do not know how the Government arrived at this conclusion, for we have found nothing which sustains it. If a taxpayer engages in two or more businesses, carry-backs or carry-overs from one may clearly apply against the earnings from another. Under section 122 the controlling test is not whether the income and the loss derive from the same assets, but whether they are both attributable to the same taxpayer. See further *Northway Securities Co.*, 23 B.T.A. 532 (1931); *Alprosa Watch Corp.*, 11 T.C. 240 (1948); *A. B. & Container Corp.*, 14 T.C. 842 (1950); *Wage, Inc.*, 19 T.C. 249 (1952). In these cases the taxpayer changed its business, and the profits of one enterprise were reduced by allowances of another.

[67] The Government states that "it is far from clear that the deduction in controversy" here "would have been allowable under the 1954 Code." Resp. Br. 18, n. 3. This statement is at odds with the statute just cited.

newly combined enterprise. And Congress again deemed it appropriate to allow the carry-over of losses even though the carry-over may inure to the benefit of a new controlling group. Apart from the prior limitation in regard to "principal purpose,"[68] Congress added only one other condition. After the fusion of various businesses the shareholders of the loss corporation must own at least 20 percent of the stock in the integrated enterprise. Int. Rev. Code of 1954, § 382(b). See Sen. Rep. No. 1622, 83d Cong., 2d Sess. 284-286.[69]

This chapter of legislative history speaks for itself. Whenever Congress has been disturbed by tax avoidance through mergers, it has expressly addressed itself to that problem. But Congress has continuously been undisturbed where, as in the present case, a new group has not acquired control or, indeed, any interest in the resulting corporation.[70] In talking of tax avoidance the Government is dis-

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[68] Section 129 of the 1939 Code has been re-enacted as section 269 of the 1954 Code.

[69] Even this limitation does not apply where, if, as in this case, the corporations involved in the merger "are owned substantially by the same persons in the same proportion." Int. Rev. Code of 1954, § 382(b)(3).

[70] The Government says that section 382(a)(1)(C) of the 1954 Code "precludes a carry-over even by the same corporation unless, among other things, the corporation continues to carry on 'substantially the same' business." Resp. Br. 42. While that statute is not concerned with mergers and is irrelevant here, we should note that the Government's summary of the statute is less than complete. First, the statute does not apply unless there has been a change in ownership of as much as 50 percent of the stock. Second, though such a change in ownership has occurred, the losses of one existing business may be offset against the profits of another existing business, as long as both are continued for at least a limited period. Third, the statue does not bar the addition of a new business, and the carry-over of prior losses against the profits of the new business. See Conf. Rep. No. 2543, 83d Cong., 2d Sess. 40 (1954).

ingenuously improvising a tax policy of its own which Congress has consistently rejected.[71]

The Government's own analysis sheds a revealing light on the solution which it now proposes. For the Government concedes that under its view of section 122 the profit of one corporation can also be combined with the loss of another.[72] A simple example illustrates the nature of the Government's reasoning. Assume that corporations *A* and *B* are engaged in different businesses; and that *A* has profits and *B* has losses. The Government agrees that if *A* merges into *B*, the prior losses of *B* are available as a carry-over against later earnings from assets contributed by *A*. The corporation that takes the deduction derives originally from the same certificate as the corporation that has sustained the loss—and hence they constitute the same legal entity. But if *B* merges into *A*, the carry-over is supposedly gone. To borrow the Government's words, "the availability of the net operating loss deduction" is "de-

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[71] The Government contends that section 381 of the 1954 Code constitutes a change in law with respect to the loss carry-overs of merged corporations. Resp. Br. 17-18. In making this argument it refrains from quoting relevant portions of the Finance Committee report. The report states that under prevailing interpretations of the 1939 Code the carry-over of losses hinges on the form of the reorganization; and then it emphasizes that the rules are being broadened so that the carry-over will "depend less upon the form of the transaction" than its economic effects. Sen. Rep. No. 1622, 83d Cong., 2d Sess. 52 (1954). Of course, we are not relying on section 381 as a retroactive resolution of the present dispute. We are simply denying what the Government is asserting—that a change in statutory language necessarily means a change in law in regard to mergers. In so far as mergers are concerned, the revision more readily indicates that Congress wished to clarify the existing rule applicable to mergers, while extending the same rule to other corporate fusions. Cf. *Helvering* v. *New York Trust Co.*, 292 U.S. 455, 468-469 (1934); *Haggar Co.* v. *Helvering, supra,* at 399-400; *Higgins* v. *Smith, supra,* at 479-480; *Commissioner* v. *Wheeler, supra,* at 545-546.

[72] Resp. Br. 34, n. 16.

pendent upon which of two or more corporations survives a merger."[73] Or to restate this conclusion, the solution "seems to be sought in terms of which legal entity swallowed the other." *Stanton Brewery* v. *Commissioner, supra,* at 574. Due respect for Congress suggests that such "unwitty diversities" should not be freely attributed to it—particularly when they possess no relevance for tax purposes.[74] Cf. *Helvering* v. *Hallock, supra,* at 118.

D. The Government has tried hard to build a small argument on a relief provision enacted in 1947. Act of July 15, 1947, c. 249, 61 Stat. 324, 26 U.S.C.A. § 122 note. Under this statute a railroad emerging from bankruptcy may carry over net operating losses and unused excess profits credits even though it has been reorganized under a new charter and prior corporate attributes have come to an end. See H. R. Rep. No. 624, 80th Cong., 1st Sess. According to the Government, this legislation "affirmatively" shows that after a merger the resulting corporation may not carry over the losses of a component corporation. Otherwise "there obviously would have been no need for the enactment of the 1947 statute."[75]

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[73] *Ibid.*

[74] The Government usually looks askance at such incongruities. It seeks to excuse its present change of mind by resorting to a generality—"tax consequences flow from what the taxpayer does, not from what it might have done." In reply we need only quote what this Court said in response to another aphorism invoked by the Government. "As so broad and unchallenged a principle furnishes only a general direction, it is of little value in the solution of tax problems." *Higgins* v. *Smith,* 308 U.S. 473, 476 (1940). If the generality were as informative as the Government assumes, a good many tax cases which it has won would have been decided differently. See, *e.g., Gregory* v. *Helvering,* 293 U.S. 465 (1935); *Raybestos-Manhattan Co.* v. *United States,* 296 U.S. 60 (1935); *Minnesota Tea Co.* v. *Helvering,* 302 U.S. 609 (1938); *Helvering* v. *Horst,* 311 U.S. 112 (1940). Saws and adages do not decide tax cases.

[75] See Resp. Br. 16-17.

The argument overlooks the purport of the railroad legislation. The statute of 1947 grants, in a closely confined context, a special dispensation for the benefit of new taxpayers. In regard to loss carry-overs of reorganized railroads, it provides that a new taxpayer shall be treated as if it were a continuing taxpayer. A carry-over is allowed regardless of whether the railroad has started corporate life afresh or kept intact the prior attributes of corporate existence.[76] In view of this legislative objective it is similarly immaterial whether the railroad assets have been acquired in a tax-free reorganization.[77] The committee reports expressly note that the amendment covers cases "where the predecessor corporation has continued in existence after the acquisition by the new corporation;" and then they enunciate a principle for allocating carry-overs between the two corporations where both continue to exist.[78]

We do not discern how the statute of 1947 helps the Government. And we are quite surprised that the Government mentions it at all. As the Second Circuit has pointed out, at best the railroad statute "suggests" that the Government is wrong. The purpose of the statute "was limited to remedying inequalities of treatment among the railroads in reorganization, where the reorganized corporation was not regarded as the same taxpayer." It casts no adverse "light upon the situation where a corporation resulting from a merger has been recognized on the authorities as the same taxpayer as its component corpora-

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[76] Needless to say, these railroad reorganizations are sharply dissimilar from statutory mergers because the liabilities of the predecessor corporation are not transferred in gross to the successor corporation. In fact, the basic design of the reorganization is to alter the debt structure.

[77] See Int. Rev. Code of 1939, § 113(a)(20), to which the 1947 statute cross-refers.

[78] See H. R. Rep. No. 624, 80th Cong., 1st Sess. 6 (1947); Sen. Rep. No. 406, 80th Cong., 1st Sess. 4 (1947).

tions." *Stanton Brewery* v. *Commissioner, supra,* at 577. See also *Koppers Company* v. *United States, supra,* at 297; *E. & J. Gallo Winery* v. *Commissioner, supra,* at 706. In the present case the Eighth Circuit did not even regard the statute as sufficiently relevant for discussion.

E. One other small matter remains to be mentioned. Whenever the Government is displeased by a tax deduction, we may expect it to invoke the familiar canon that deductions are a matter of legislative grace. Of course, once more we have not been surprised by any deviation from the usual practice.[79] As on so many other occasions, a tax deduction is regarded as a penal provision directed against the Government and hence to be grudgingly applied in a niggardly fashion.[80] This Court, however, has already said all that need be said on this kind of statutory construction. Deduction statutes, like other tax statutes, are to be applied in response to "the legislative policy expressed in the fair and natural meaning" of the words used by Congress. *Lykes* v. *United States,* 343 U.S. 118, 120 (1952). See also *Commissioner* v. *Korell, supra,* at 627-628; Griswold, Note, 56 Harv. L. Rev. 1142 (1943).[81] Even where

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[79] Resp. Br. 5, 10-11. The Government also describes the net operating loss deduction as "a sharp departure from our established system of annual accounting periods." *Id.* at 11. See also *id.* at 5. Apparently this observation is designed to suggest that carry-backs and carry-overs are some sort of exotic exception in our income tax law. Actually the situation is quite different. Carry-backs and carry-overs are no more exceptional than any other well established deduction. They articulate a general and pervasive principle which governs the taxation of all business income.

[80] This Court has held that penal statutes, too, "should be given their fair meaning in accord with the evident intent of Congress." *United States* v. *Sullivan,* 332 U.S. 689, 693 (1948). See also *United States* v. *Brown,* 333 U.S. 18, 25 (1948); *Kordel* v. *United States,* 335 U.S. 345, 349 (1948).

[81] As tax rates continue to cut wide and deep, it is especially important that the tax base be confined to the taxpayer's true profit.

the deduction claimed is "an unexpected windfall," it "will not be withheld" if it "is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole." *Lewyt Corp.* v. *Commissioner, supra,* at 240.[82] The obligations of a taxpayer stem from the words used by Congress. Whether a disputed item involves gross income or a deduction, statutory interpretation is a good deal more than a mechanical resort to canons of construction. See Frankfurter, *Some Reflections on the Reading of Statutes,* 47 Col. L. Rev. 527, 544 (1947). "Indeed, nothing is so likely to lead us astray as an abject reliance upon canons of any sort; so much the whole history of verbal interpretation teaches, if it teaches anything." *Van Vranken* v. *Helvering,* 115 F. 2d 709, 711 (2d Cir. 1949), *cert. denied,* 313 U.S. 585 (1941).

In the felicitous phrasing of Judge Learned Hand, "interpretation is the art of proliferating a purpose which is meant to cover many occasions so that it shall be best realized upon the occasion in question." *Brooklyn Nat. Corp.* v. *Commissioner,* 157 F. 2d 450, 451 (2d Cir. 1946), *cert. denied,* 329 U.S. 733 (1946). See also *Universal Camera Corp.* v. *Labor Board,* 340 U.S. 474, 489 (1951). Here, we believe, the purpose of Congress is "best realized" by our reading of the statute. The resulting corporation in a statutory merger is "the taxpayer" for other purposes of the Internal Revenue Code, and no adequate reason has been given for reading section 122 differently. We fully agree with what the Government stated many years ago in a related context. If the resulting corporation "must bear all the burdens" of the component corporation, "it is likewise entitled to all the privileges of that corporation." G.C.M. 7310, *supra,* at 240. Our view has other virtues, too, which the Eighth Circuit's opinion lacks. It "safeguards

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[82] Cf. *Helvering* v. *Union Pacific Co.,* 293 U.S. 282, 284 (1934), which sustained a deduction in the absence of any statute "specifically authorizing" it.

the interests of the Government,[83] interprets a business transaction according to its tenor, and avoids gratuitous resentment in the relations between Treasury and taxpayer." *Rosenman* v. *United States, supra,* at 663.

## CONCLUSION

The decision of the Court of Appeals is erroneous and should be reversed.

Respectfully submitted,

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[83] See discussion of section 129, *supra,* at pp. 45-50.

# APPENDIX

BUREAU OF INTERNAL REVENUE

INCOME TAX UNIT

PENSION TRUST DIVISION INFORMATION SERVICE

PS No. 62 May 5, 1950

Section 23 (p)(1)(A)(iv)—Carry overs of Pension and Annuity Contributions in Excess of Allowable Deductions.

Section 29.23(p)-8—Contributions Under Pension and Annuity Plans in Excess of Limitations Under Section 23(p)(1)(A).

*Internal Revenue Agents in Charge and Others Concerned:*

Advice has been requested with respect to the application of the carry-over provisions of section 23(p)(1)(A)(iv) of the Internal Revenue Code, specifically in regard to deductions for contributions made by a predecessor company to fund past service credits under a pension plan which was subsequently taken over by a new company. The case in point is that of the M Company which paid $500,000.00 in 1947 to completely fund past service credits and deducted one-tenth, or $50,000.00 in each of the years 1947, 1948, and 1949, leaving a balance of $350,000.00 in 1949 when the corporation was liquidated and its business and all assets and liabilities were taken over, pursuant to a statutory merger, by the N Company which also assumed and continued the pension plan. The inquiry made is whether the balance of $350,000.00 will be allowable as a deduction to either company.

As to the M Company, having already deducted in 1949 $50,000.00, which is the "amount not in excess of 10 per centum of the cost which would be required to completely fund or purchase such pension or annuity credits as of the date when they are included in the plan" [section 23 (p)(1)(A)(iii)], there is nothing further that it may deduct in that year. Also, having been liquidated in 1949 there will be no occasion for further deductions.

As to the N Company, the problem involved is one to be resolved in accordance with the line of distinction to be drawn between *New Colonial Ice Company, Inc.* v. *Helvering*, (1934) 292 U.S. 435, and *Helvering* v. *Metropolitan Edison Company*, (1939) 306 U.S. 522. In *New Colonial Ice Company, Inc.* v. *Helvering, supra*, a new corporation was denied a deduction in respect of net operating losses previously sustained by another corporation the assets of which had been acquired, subject to liabilities, for stock of the successor, the old corporation being subsequently dissolved. In *Helvering* v. *Metropolitan Edison Company*, following mergers consummated pursuant to state law and in connection with which a parent corporation acquired the assets, subject to liabilities, of its subsidiaries the parent was allowed to deduct unamortized discount and expense on bonds issued by the subsidiaries prior to the mergers.

Accordingly, since the N Company acquired the assets of the M Company pursuant to a statutory merger which by operation of law effected a fusion of the assets and liabilities of the respective companies it is entitled to deductions in succeeding years, commencing with 1950, with respect to the balance of $350,000.00 to the same extent as the M Company would have been entitled had it continued in business.

Correspondence regarding this release should refer to the number and to the symbols IT:PS.

E. I. McLARNEY,
*Deputy Commissioner.*